

The Rise Of Islamic Financial Institutions In Market Economies

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ABSTRACT

This article explores the evolution and operational mechanics of Islamic financial institutions (IFIs) and the instruments they employ within the framework of Sharia-compliant finance. It highlights the structural differences between Islamic and conventional banking systems. The study also assesses the current global footprint of IFIs and examines their growth potential within the broader international financial landscape.

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Introduction

The Islamic financial system represents a distinct paradigm in global finance, characterized by institutions and instruments that operate in strict adherence to Sharia. Unlike conventional systems driven by interest-based transactions, Islamic finance prioritizes risk-sharing, asset-backing, and ethical investment.

The global expansion of IFIs is not merely a reflection of rising demand from Muslim populations but also a result of substantial liquidity accumulation in oil-exporting nations. Over the medium term, these trends are expected to persist as energy-rich economies continue to develop their financial markets and seek Sharia-compliant investment channels.

In recent years, conventional financial institutions have shown growing interest in Islamic finance. Many multinational banks now operate “Islamic windows” dedicated sections offering Sharia-compliant products. This shift is driven by demographic changes in Western countries, where Muslim communities are growing, and by the desire of Islamic investors to diversify their portfolios geographically.

The increasing penetration of IFIs in the United States and Western Europe suggests that similar institutions may eventually emerge in Uzbekistan’s financial system. However, their integration requires legal reforms and poses challenges to monetary policy and financial stability.

Literature Review

The effectiveness and operational criteria of Islamic financial institutions have been examined by numerous scholars, including r.Bekkin [7], E.Biryukov [8], S.Ghosh [9], R.Haron [10] and others. A.Zhuravlev (2017) noted that, given an appropriate legal framework, conventional and Islamic financial institutions can operate within the same regulatory environment, potentially governed by two separate sets of laws [1].

Further research on the efficient functioning and growth of Islamic finance has been conducted by Y.Gambeva and S.Medvedeva (2018) outlined the foundational principles of Islamic finance, the operational framework of IFIs, and the financial instruments used within the system [2].

Y. Baidalet, an economist from Kazakhstan, highlights a defining characteristic of Islamic financing: its foundation in real, tangible assets. In contrast to the conventional capitalist model, where banks and financial

institutions primarily trade money and monetary obligations, the ethical system of Islamic finance ensures that every form of financing generates real added value. Baidaulet notes that conventional interbank lending tends to create excess money supply that often circulates beyond actual goods turnover, leading to economic distortions [3].

O. Astanakulov defines the Islamic financial system as a banking system organized and operated according to the rules of Sharia. According to his research, all banking operations – including deposit-taking, financing, money transfers, letters of guarantee, letters of credit, and foreign currency exchange must adhere strictly to Sharia guidelines. This holistic compliance distinguishes Islamic banks from conventional ones [4].

A. Tursunov describes an Islamic bank as a commercial entity that opens and maintains accounts, processes payments, mobilizes funds through deposits, provides financing to individuals and legal entities, and offers other banking services – all in accordance with Islamic Sharia. He stresses that Sharia prohibits the payment or receipt of interest (riba) in any transaction and restricts financing only to production projects that are deemed permissible (halal) and safe for society [5].

S. Abrorov concludes that, based on conceptual principles and Sharia rules, Islamic finance has developed alternative financial instruments to replace those used in conventional finance that are incompatible with Islam. He classifies these Islamic financial instruments into four main groups: profit-and-loss sharing (mudarabah, musharakah), benevolent loans (qard hasan), leasing (ijara), and mutual guarantee arrangements (kafalah, takaful). This classification provides a practical framework for understanding the operational toolkit of IFIs [6].

Methodology

This study adopts a dialectical approach to understanding the evolution of IFIs. Methodological tools include analysis, synthesis, classification, systemic comparison, induction, deduction, and statistical evaluation. Both general scientific and specialized methods are employed to ensure a comprehensive assessment.

Analysis and discussion

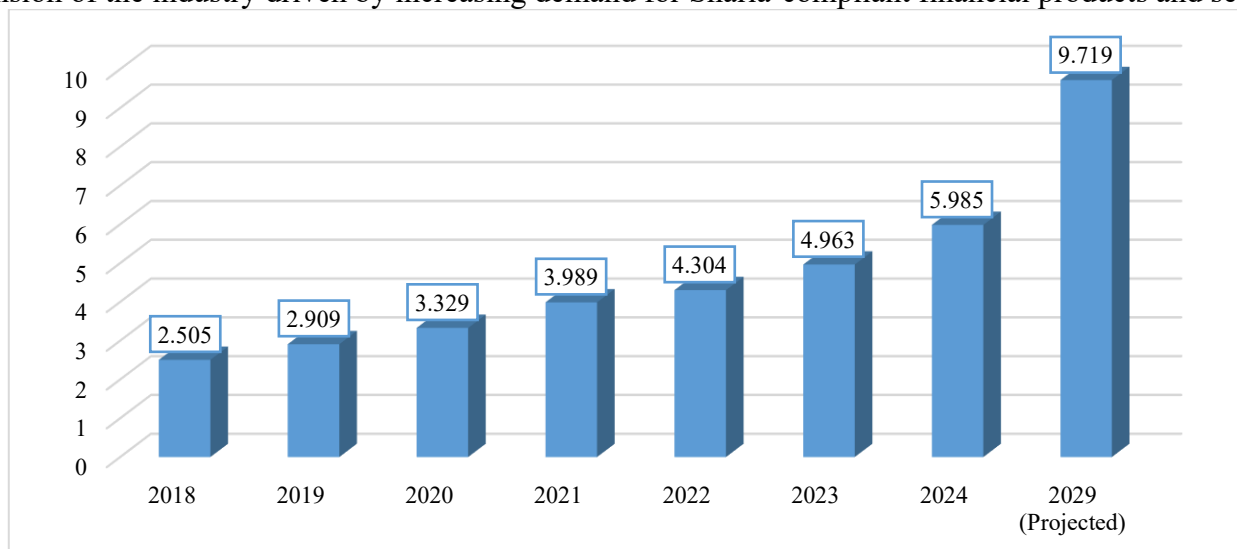
Over the past decade, Islamic finance has evolved from a niche area into a mainstream component of the global financial system. Its growing relevance is particularly evident in developed economies such as the United Kingdom and the United States, where increasing Muslim populations and demand for ethical, Sharia-compliant financial products have driven institutional and regulatory adaptation. As a result, Islamic finance is no longer confined to Muslim-majority countries but has become an important consideration for financial markets operating in diverse socio-economic contexts.

The Islamic financial system is composed of several interrelated components that collectively ensure its functionality and compliance with Sharia principles. At its core are Islamic banks, which include both fully Sharia-compliant institutions and Islamic windows within conventional banks. These institutions perform traditional financial intermediation functions while adhering to principles such as the prohibition of interest (riba) and excessive uncertainty (gharar). Alongside them, non-banking Islamic financial institutions, such as leasing companies, microfinance providers, private equity funds, and charitable organizations, play a complementary role in expanding access to finance and supporting economic development.

Another essential component is takaful, or Islamic insurance, which operates on the basis of mutual risk-sharing and cooperation, distinguishing it from conventional insurance models that involve elements of uncertainty and speculation. In parallel, Islamic capital markets provide avenues for investment and capital raising through Sharia-compliant instruments, including sukuk, and involve various intermediaries such as brokers and investment banks. These markets contribute to the diversification and deepening of the Islamic financial system.

Finally, the effectiveness of the Islamic financial ecosystem depends on a robust supporting infrastructure. This includes payment and settlement systems, Sharia screening and compliance mechanisms, regulatory and supervisory authorities, auditing institutions, and rating agencies. Together, these elements form an integrated framework that facilitates transparency, stability, and sustainable growth within the Islamic finance industry. Picture 1 illustrates the growth of Islamic finance assets over the period 2018-2024, along with projections

extending to 2029. It demonstrates a consistent upward trend in total asset value, indicating the steady expansion of the industry driven by increasing demand for Sharia-compliant financial products and services.



Picture 1. Islamic finance asset growth (2018-2029) (bn USD) [11]

The data shows a strong and consistent upward trend in global Islamic finance assets between 2018 and 2024. Assets increased from USD 2,505 billion in 2018 to USD 5,985 billion in 2024, more than doubling within six years. The growth is particularly noticeable after 2020, where expansion accelerates each year, reflecting rising demand for Sharia-compliant financial products, broader adoption of Islamic banking systems, and increasing investor interest in ethical finance structures.

Looking ahead, the projection for 2029 suggests that Islamic finance assets could reach around USD 9,719 billion. This indicates continued rapid expansion, driven by the development of Islamic capital markets, especially sukuk, as well as growth in banking and financial institutions across key regions. Overall, the chart highlights that Islamic finance is not only growing steadily but also gaining global financial significance as a parallel financial system. Table 1 illustrates the structure of global Islamic finance assets in 2024 and clearly highlights the dominant position of Islamic banking as the largest segment within the industry.

Table 1

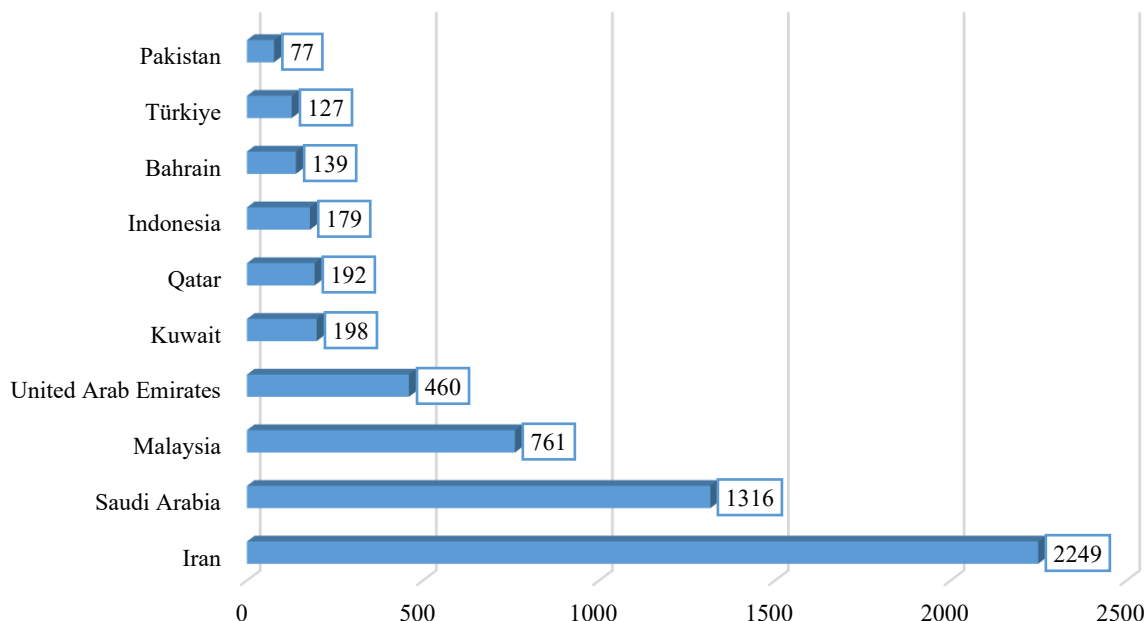
Global Islamic Finance Assets Breakdown in 2024 (bn USD) [11]

Category	Total Assets	Share of IF Assets	Number of Institutions / Instruments
Islamic Banking	4,3	72	681
Sukuk	1,0	17	4712
Islamic Funds	0,31	5	2610
Other Islamic Financial Institutions	0,19	3	1179
Takaful	0,14	2	395

The global Islamic finance assets in 2024 are heavily dominated by Islamic banking, which accounts for about USD 4.3 trillion, representing roughly 72% of total Islamic finance assets. This shows that traditional banking activities based on Sharia principles remain the core segment of the industry. In addition, there are 681 Islamic banking institutions, indicating a relatively large and well-established banking network compared to other segments.

Other components of Islamic finance are significantly smaller but still important for diversification. Sukuk (Islamic bonds) represent around USD 1.0 trillion or 17% of total assets, supported by 4,712 instruments, making it the second-largest segment. Islamic funds (5%, USD 0.31 trillion), other Islamic financial institutions (3%, USD 0.19 trillion), and takaful (Islamic insurance, 2%, USD 0.14 trillion) together show that while capital markets and insurance are growing, they still play a much smaller role compared to

banking within the overall Islamic finance ecosystem. The picture 1 shows Islamic finance assets by country in 2024 and highlights a clear concentration of assets in a few leading countries.



Picture 2. Islamic finance assets by country in 2024 (bn USD) [11]

The data on Islamic finance assets by country in 2024 demonstrates a highly concentrated structure, with a significant share of total assets held by a few leading economies. Iran (2249 billion USD), Saudi Arabia (1316 billion USD), and Malaysia (761 billion USD) dominate the global landscape, collectively accounting for the majority of Islamic financial assets. This concentration indicates that the development of Islamic finance is strongly dependent on a limited number of core countries with well-established financial systems and supportive regulatory frameworks.

From a regional perspective, the Middle East (particularly the Gulf Cooperation Council (GCC) countries) plays a central role due to its substantial capital resources derived from oil revenues and strong government backing of Sharia-compliant finance. At the same time, Malaysia represents a model of institution-driven growth, supported by advanced legal infrastructure and innovation in Islamic financial instruments such as sukuk. Other countries like Indonesia, Türkiye, and Pakistan show emerging potential but still hold relatively smaller shares of global assets.

Overall, the distribution of Islamic finance assets reflects both economic capacity and institutional development. Countries with robust regulatory environments, strong banking sectors, and active capital markets tend to achieve higher levels of growth in Islamic finance. This suggests that future expansion of the industry will likely depend on improving financial infrastructure and regulatory support in emerging markets, alongside sustained growth in established hubs. Table 2 presents the growth of Islamic finance industry assets over the period 2012-2024 and highlights a steady upward trend in total asset value.

**Table 2
Islamic finance industry assets (2012-2024, US\$ bn) [11]**

Year	Islamic finance	Islamic banking	Sukuk outstanding
2012	1,787	1,356	213
2013	1,754	1,281	247
2014	2,040	1,440	347
2015	2,085	1,510	306
2016	2,198	1,543	349
2017	2,409	1,636	420
2018	2,505	1,685	470
2019	2,909	1,970	538

2020	3,329	2,264	626
2021	3,898	2,680	713
2022	4,304	3,024	788
2023	4,963	3,557	863
2024	5,985	4,318	1,031

The data on Islamic finance industry assets from 2012 to 2024 (in billion US dollars) demonstrate a strong and sustained upward trajectory, reflecting the rapid expansion of the sector over the past decade. Total Islamic finance assets increased from 1,787 billion USD in 2012 to 5,985 billion USD in 2024, representing more than a threefold growth. This trend indicates the rising global demand for Sharia-compliant financial services and the increasing integration of Islamic finance into the international financial system.

A key observation from the table is the dominant role of Islamic banking, which consistently accounts for the largest share of total assets throughout the period. Islamic banking assets grew from 1,356 billion USD in 2012 to 4,318 billion USD in 2024, highlighting its central position as the primary driver of industry growth. This dominance can be attributed to the well-established institutional frameworks, strong customer base, and the essential role of banking services in financial intermediation within Islamic economies.

In addition to banking, the sukuk market has shown significant expansion, with outstanding sukuk increasing from 213 billion USD in 2012 to 1,031 billion USD in 2024. This rapid growth reflects the increasing importance of Islamic capital markets in providing alternative financing instruments for governments and corporations. Sukuk has become a key tool for infrastructure financing and liquidity management, contributing to the diversification of the Islamic finance industry.

Overall, the data highlight both growth and gradual diversification within the Islamic finance sector. While Islamic banking remains the dominant segment, the increasing share of sukuk indicates a shift toward more balanced development across different components of the industry. This evolution suggests that the future growth of Islamic finance will depend not only on banking expansion but also on the continued development of capital markets and other financial segments.

Conclusion

Islamic finance has evolved from a niche segment into a rapidly expanding and structurally significant component of the global financial system. The analysis demonstrates a consistent and robust growth trajectory of Islamic finance assets, which increased from USD 1.8 trillion in 2012 to nearly USD 6.0 trillion in 2024, with projections indicating continued expansion up to approximately USD 9.7 trillion by 2029. This sustained growth reflects rising global demand for Sharia-compliant financial products, increasing integration of Islamic finance into mainstream financial markets, and the strengthening role of ethical and asset-backed financing structures.

The structure of the industry remains highly concentrated, with Islamic banking dominating the sector, accounting for approximately 72% of total Islamic finance assets in 2024. Sukuk markets represent the second-largest segment, while Islamic funds, takaful, and other financial institutions play complementary but comparatively smaller roles. This composition highlights that although diversification is gradually increasing, Islamic banking continues to be the primary driver of sectoral growth and stability. Geographically, Islamic finance assets are concentrated in a limited number of countries, particularly Iran, Saudi Arabia, and Malaysia, indicating that institutional strength, regulatory frameworks, and resource availability remain key determinants of sectoral development.

From a policy and strategic perspective, the findings suggest that Islamic finance offers substantial opportunities for financial diversification, capital mobilization, and enhanced financial stability, particularly for emerging economies such as Uzbekistan. However, its development also requires a strong institutional ecosystem, including supportive legal frameworks, Sharia-compliant regulatory infrastructure, and well-developed financial markets. At the same time, the increasing interconnectedness of Islamic financial institutions with conventional banking systems underscores the importance of effective risk management and regulatory oversight to ensure systemic stability.

Overall, the empirical evidence confirms that Islamic finance is not only experiencing quantitative expansion but is also gaining qualitative importance within the global financial architecture. Its future development will depend on continued innovation in Islamic capital markets, expansion of non-banking financial segments, and harmonization of regulatory standards across jurisdictions.

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